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# INTERNATIONAL TAX COOPERATION AND A MULTILATERAL TREATY

Victor Thuronyi\*

## I. INTRODUCTION

The public international law of taxation is dominated by over 1,500<sup>1</sup> bilateral treaties (the number goes up steadily) for the prevention of double taxation of income and capital. Virtually all of these are based on a single model treaty (the Organisation for Economic Co-operation and Development (OECD) Model<sup>2</sup>), and therefore exhibit a high degree of uniformity. This treaty network has been called a "triumph of international law" and a framework for an international tax regime based on the principles underlying these treaties.<sup>3</sup> It has become apparent, however, that the bilateral nature of this treaty network involves inherent flaws which have become more serious as the network has grown. The treaty network has become cumbersome and inflexible and, in many instances, has spawned opportunities for tax avoidance. This bilateral approach seems anomalous in an era where taxpayers have become global and many other regulatory areas increasingly are being dealt with globally by governments.<sup>4</sup>

This paper discusses why it would be desirable to replace the existing bilateral network with a multilateral treaty (administered by an appropriate international organization) and

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1. See Michael Graetz, *Taxing International Income: Inadequate Principles, Outdated Concepts and Unsatisfactory Policies*, 26 BROOK. J. INT'L L. 1357 (2001). The figure of 1,500 is given in OECD, *TAX SPARING: A RECONSIDERATION* 14 (1998). Over the past decade, around 75 treaties have been added each year.

2. OECD COMMITTEE ON FISCAL AFFAIRS, *MODEL TAX CONVENTION ON INCOME AND ON CAPITAL* (2000) (condensed version). There are other models, for example the U.S. and U.N. models, but these also are based on the OECD Model.

3. See Reuven S. Avi-Yonah, *Commentary*, 53 TAX L. REV. 167, 169 (2000); David Rosenbloom, *International Tax Arbitrage and the "International Tax System"*, 53 TAX L. REV. 137, 164 (1999).

4. See John F. Avery Jones, *Are Tax Treaties Necessary?*, 53 TAX L. REV. 1, 1 (1999); DAVID W. WILLIAMS, *TRENDS IN INTERNATIONAL TAXATION* 87-93 (1991).

how this could be done.<sup>5</sup> In contrast with most previous discussions, which have tended to conclude that a multilateral treaty would be desirable but impracticable,<sup>6</sup> I focus here on how it might be possible to achieve this goal and why it is increasingly important to do so.<sup>7</sup>

As an ideal type,<sup>8</sup> a multilateral treaty would replace the

5. A similar diagnosis was formulated by Richard J. Vann, *A Model Tax Treaty for the Asian-Pacific Region?*, 45 BULL. INT'L FISCAL DOCUMENTATION 151, 157-60 (1991) (arguing that the OECD Model is "reaching an impasse in the transfer pricing area," and that apportionment on a multilateral basis is required to deal with multinational corporate groups). Vann also argues that the Model is irrelevant or inappropriate in dealing with issues such as thin capitalization, foreign currency conversion, and finance leasing. He suggests that an international organization structured along the lines of the GATT (now WTO) would lend needed flexibility to deal with these and other international issues. Along similar lines, Michael Rigby, *A Critique of Double Tax Treaties as a Jurisdictional Coordination Mechanism*, 8 AUSTRALIAN L. F. 301 (1991), argues that existing treaties have not been successful in the areas of controlled foreign corporations, thin capitalization, and transfer pricing, and that the existing treaty network is insufficiently flexible. WILLIAMS, *supra* note 4, at 166, finds that "the logic of present trends is towards a web of many thousands of agreements, being updated at an increased rate, and being subject both to treaty overrides by national legislation and disparate judicial and administrative interpretations and applications." He considers a "piecemeal multilateral approach," whereby "some part of the content of double taxation agreements could be standardised" to be a partial solution to these problems. *See id.* at 167. VITO TANZI, *TAXATION IN AN INTEGRATING WORLD* (1995), argues that globalization is putting tax systems under substantial pressure and that the coordinating role of the OECD "falls far short of what it needs to be on a worldwide scale . . . . There is no world institution with the responsibility to establish desirable rules for taxation and with enough clout to induce countries to follow those rules. Perhaps the time has come to establish one."

6. *See, e.g.*, OECD, *supra* note 2, ¶ 40 at 17 ("there are no reasons to believe that the conclusion of a multilateral tax convention involving all Member countries could now be considered practicable"); Vann, *supra* note 5; *Outgoing Treasury Staffer Discusses Treaty Policy*, 76 TAX NOTES 1536 (1997) ("It has not proven practical to have a multilateral tax treaty."); ARNOLD A. KNECHTLE, *BASIC PROBLEMS IN INTERNATIONAL FISCAL LAW* 188-90 (1979). Joel Slemrod, *Tax Cacophony and the Benefits of Free Trade*, in 1 FAIR TRADE AND HARMONIZATION 283, 304-06 (J. Bhagwati & R. Hudec eds., 1996) makes the related point that multilateral coordination of tax systems will be difficult to achieve as a political matter.

7. I assume that a certain degree of fiscal coordination is desirable. *See* Peggy Musgrave & Richard Musgrave, *Fiscal Coordination and Competition in an International Setting*, in INFLUENCE OF TAX DIFFERENTIALS ON INTERNATIONAL COMPETITIVENESS 61 (Charles E. McLure, Jr. et al. eds., 1990). Alec Easson's words come to mind in this context: "If the existing system is so defective as to require radical change, yet every proposal for such a change is dismissed as utopian, it ought to be possible to devise less radical proposals that could conceivably be adopted and that would result at least in substantial improvements." Alec Easson, *A New International Tax Order - Responding to the Challenge*, 45 BULL. INT'L FISCAL DOCUMENTATION 465 (1991).

8. It would be possible to go even further and envision an internationally

existing treaty network with a single uniform text. Those experienced in treaty negotiation rightly have pointed out that it would be impossible to achieve such uniformity without substantial political will and harmonization of tax systems. Neither is forthcoming in the near future. But it is possible to approach this ideal in a gradual manner,<sup>9</sup> as discussed in Section IV below. Exactly how this is to be done would be the subject of negotiation, but in broad outlines what I envision is an agreement with several parts. First, there would be a uniform text covering the same material as the existing OECD Model, and probably closely based on that model in terms of drafting. This text would serve as a "template" for those bilateral treaty relationships that would continue to exist alongside the multilateral treaty. All countries joining the agreement would sign on to this template. Second, there would be one or more multilateral treaties, consisting of the bilateral template, with necessary adjustments in light of the multilateral nature of the treaty. In contrast to the bilateral template, only a limited set of countries would, in all likelihood, be willing to subscribe to a multilateral treaty. As explained below, the most likely candidates would be the European Union (EU) member countries. Third, there would be additional agreements going beyond the scope of the current OECD Model. Fourth, an institutional framework would be established to manage the treaty, including the granting of jurisdiction to an international organization with membership open to all countries. Finally, transition arrangements and derogations would deal with the process of folding the existing treaty network into the new treaty. Existing treaties could be kept in force until negotiators had the opportunity to review each treaty and bring it into line with the new framework to the extent desired, with any re-

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harmonized system. However, this seems too utopian to merit discussion as a politically feasible alternative. See Richard Bird, *Shaping a New International Tax Order*, 42 BULL. INT'L FISCAL DOCUMENTATION 292, 297 (1988).

9. The idea of a "partial" multilateral approach has been raised by Helmut Loukota, *Multilateral Tax Treaty Versus Bilateral Treaty Network*, in MULTILATERAL TAX TREATIES: NEW DEVELOPMENTS IN INTERNATIONAL TAX LAW 85, 98-99, 103 (Michael Lang et al. eds., 1998). See also WILLIAMS, *supra* note 4, at 167; Bird, *supra* note 8, at 298 (recognizing that a reformulation of the international tax system "can only be worked out by the interested parties over a long period of time through continued, and no doubt painful, negotiations in some appropriate international forum").

maintaining differences dealt with by derogation. Future treaties would be negotiated within the new framework.

While not as tidy as replacing all existing treaties in one fell swoop, the proposed approach has the advantage of being more realistic and of bringing many of the benefits of multilateralism, even though complete uniformity is not achieved. The agreement would simplify substantially the steadily increasing verbiage of the bilateral treaty network. Most importantly, the proposed arrangement would put in place a *process* under which countries could work on resolving the substantive problems with the international tax system that many commentators have identified.

The advantages of a multilateral treaty over a bilateral network long have been recognized.<sup>10</sup> In contrast to the existing network of bilateral treaties, which has become ossified, a multilateral treaty would provide a vehicle for continual renewal as problems arise with the functioning of the international tax system, allowing amendment or interpretation of its terms to affect all countries at the same time. A multilateral treaty also would provide a framework for continuous review of the relevance of those weaknesses that remain. It would allow consideration of solutions (such as the apportionment of income of multinationals among the countries in which they operate) that cannot be applied on a bilateral basis alone. A multilateral treaty would be able to handle triangular cases and treaty shopping much better than a bilateral network. Such a treaty also could cover taxes other than the income tax, such as social security, value added taxes (VAT), estate and gift taxes, and excises, as well as tax procedural questions. While in principle it would be possible to extend the existing bilateral treaty network to cover such taxes, in practice the negotiations would be so lengthy that such an extension would

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10. See, e.g., UNITED NATIONS, UNITED NATIONS MODEL DOUBLE TAXATION CONVENTION BETWEEN DEVELOPED AND DEVELOPING COUNTRIES 12 (1980) ("The creation of a network of bilateral tax treaties based on a common model will be an important step on the way leading to the eventual conclusion of a world-wide multilateral tax convention for the avoidance of double taxation."); Loukota, *supra* note 9, at 86-88; Michael Lang, *The Concept of a Multilateral Tax Treaty*, in MULTILATERAL TAX TREATIES: NEW DEVELOPMENTS IN INTERNATIONAL TAX LAW 189 (Michael Lang et al. eds., 1998). GARY HUFBAUER, U.S. TAXATION OF INTERNATIONAL INCOME 169 (1992) suggests negotiation of a single tax treaty with the entire European Community.

never happen.

Let me be quite clear that I am not supposing that all the existing tax treaties can be replaced with a single uniform text. Rather, what I envisage is a situation where countries enter into a commitment to negotiate all future treaties based on such a text (and over a transitional period to bring existing treaties into a format that is based on this text). Such a commitment would not preclude countries from agreeing on wording that deviates from the uniform template. But if countries want to deviate, the deviation would have to take the form of amendments to the template. To some extent, this would be a question of form only. But it would have an effect on substance because the requirement to set forth the agreement in the form of a uniform text plus amendments would tend to limit the extent of amendment, and because countries would agree to negotiate with a view to limiting the extent of deviations. This is actually not a big difference from the current situation, because, in practical terms, countries already negotiate their treaties so as to largely hew to the text of the OECD Model. It has been noted that the OECD Model "has almost acquired the status of a multilateral instrument."<sup>11</sup> The proposal described in this paper would place the existing arrangement on a sounder legal footing. In legal terms, interpretations of the text by the international agency in charge and any agreed upon amendments would affect all the treaties that are based on the common text. That is because the bilateral treaties would take an ambulatory form: they would be based on the text as interpreted and as amended from time to time.<sup>12</sup>

While the initial focus of the proposed multilateral treaty would be to rationalize the current tax treaty network, the treaty also would present an opportunity for establishing a

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11. AMERICAN LAW INSTITUTE, *FEDERAL INCOME TAX PROJECT—INTERNATIONAL ASPECTS OF UNITED STATES INCOME TAXATION II: PROPOSALS ON UNITED STATES INCOME TAX TREATIES 3* (1992) [hereinafter AMERICAN LAW INSTITUTE].

12. This may require a certain number of clerical and conforming amendments to individual agreements when changes are made to the uniform general text. Because parliaments will have to ratify the general amendments anyway, these clerical and conforming amendments can be included in the documents to be ratified by parliaments. See Jones, *supra* note 4, at 6 (recognizing that the existing treaty network is very close to a multilateral treaty). However, in concluding that "there seems to be no obvious advantage in having multilateral tax treaties," Jones fails to consider the advantages discussed in this article. *Id.*

new international tax order. What precisely this should mean and how far international cooperation should go need not be decided *ab initio*—the process can be allowed to evolve, as with the General Agreement on Tariffs and Trade (GATT). I refrain from trying to describe here the precise elements that should be included in the initial text of the treaty, since the answer to what the treaty should contain depends on the specific dynamics of the process for negotiating the treaty.

## II. PROBLEMS OF THE EXISTING INTERNATIONAL TAX SYSTEM

The main focus of this paper is on the bilateral treaty network, so I will not dwell on other problems of the international system. These problems are in any event examined elsewhere in this Symposium and in the literature.<sup>13</sup> In addition, I do not advance particular substantive proposals for reform, but rather focus on process. It suffices for purposes of this paper, therefore, to note that there are indeed significant problems with the operation of the current international tax system and that the proposed process would provide a better framework for addressing them than the one we have today.

The international tax system, as currently constituted, is dominated by the principle of national autonomy, with only a limited degree of international coordination. It has become apparent that the existing system favors private actors—both multinational companies and wealthy individuals—who can take advantage of the lack of coordination to minimize the taxes they pay, and that the growing importance of international transactions increases the potential for such tax minimization.<sup>14</sup> Under longstanding principles of public international law, each country possesses an autonomous jurisdiction to tax persons and transactions that have a nexus with that country. When countries exercise that jurisdiction on their own, transactions that have a connection with more than one

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13. See, e.g., Alec Easson, *Taxing International Income*, in TAX CONVERSATIONS 419 (Richard Krever ed., 1997); Sven-Olof Lodin, *What Ought to Be Taxed and What Can Be Taxed: A New International Dilemma*, 54 BULL. INT'L FISCAL DOCUMENTATION 210 (2000).

14. See generally Reuven S. Avi-Yonah, *Globalization, Tax Competition, and the Fiscal Crisis of the Welfare State*, 113 HARV. L. REV. 1573, 1575-1603 (2000); SOL PICCIOTTO, *INTERNATIONAL BUSINESS TAXATION* (1992); ANTHONY GINSBERG, *INTERNATIONAL TAX PLANNING* 1-33 (1994).

country may suffer double taxation or, as a result of luck or tax planning, perhaps taking advantage of favorable tax regimes offered by countries engaging in tax competition, may escape the taxing grasp of any country. A network of tax treaties provides some coordination, in most cases eliminating double taxation between treaty countries.

Multinational corporations take advantage of the current situation by planning their affairs to exploit inconsistencies in the network of national tax laws and treaties. By dint of such tax planning, they are often able to pay substantially less tax than that paid by taxpayers whose operations are confined to a single country. As the contributions by Mintz and Tanzi to this symposium attest,<sup>15</sup> the situation has been getting worse and is likely to continue to worsen. Many businesses and individuals use a combination of tax treaties and tax havens to avoid or evade tax.<sup>16</sup> National authorities often are helpless against these tactics because they lack the information to find out what taxpayers are doing, because of practical difficulties in auditing taxpayers, or because the tax planning is allowed under current law.

Moreover, countries frequently engage in tax competition to attract investment from elsewhere, thereby undermining the tax bases of other countries. The attitude of OECD countries towards tax competition appears to be shifting. Tax sparing provisions in tax treaties—which tend to encourage developing countries to provide tax holidays and other investment incentives—have fallen into disfavor,<sup>17</sup> and multilateral agencies typically discourage developing and transition countries from offering such incentives on the basis that business usually is attracted by other factors and that precious revenue is being given away.<sup>18</sup> Nevertheless, the existing international tax sys-

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15. See Jack M. Mintz, *National Tax Policy and Global Competition*, 26 BROOK. J. INT'L L. 1285 (2001); Vito Tanzi, *Globalization, Technological Developments, and the Work of Fiscal Termites*, 26 BROOK. J. INT'L L. 1261 (2001).

16. See Victor Thuronyi, *Tax Aspects of Offshore Financial Centers*, 2 CURRENT DEV. IN MONETARY AND FIN. LAW (forthcoming 2001) for a discussion of the difference between avoidance and evasion.

17. See OECD, *supra* note 2. The OECD Council has pointed out that "the granting of tax sparing in tax conventions may offer wide opportunities for tax planning and tax avoidance" and "may have the effect of provoking harmful tax competition between countries." *Id.* at 83. The Council has recommended that, where countries continue to grant tax sparing, they do so on a limited basis and subject to safeguards. See *id.* at 42-43.

18. See OECD, *supra* note 1, at 12; Avi-Yonah, *supra* note 14, at 1643; David



tem does not give sufficient support to countries to move away from the investment incentive approach, and the current situation is characterized by substantial tax competition.<sup>19</sup>

This is not to say that the current situation is totally anarchic. Most of the industrialized countries have in place anti-avoidance rules that limit the damage (e.g., controlled foreign corporation provisions). A network of bilateral treaties covers most of the industrialized countries and eliminates virtually all cases of double taxation. Further, there is a good deal of informal coordination: Countries find out what others are doing and adopt common solutions. Moreover, the major industrialized countries have undertaken to limit harmful tax practices, although this effort is as yet at an incipient stage.<sup>20</sup>

### III. PROBLEMS WITH THE EXISTING TREATY NETWORK

The main avenue for coordination of the international tax system is a network of bilateral tax treaties for the prevention of double taxation of income and capital. This is not an ideal structure. Informed observers have known for a long time that it would be much better instead to have a multilateral treaty. However, those in charge of preparing model treaties have several times dismissed as impractical the notion that a multilateral treaty could replace the bilateral treaty network. The next section addresses this issue, acknowledging the problems with a multilateral treaty, but showing that they can be overcome. This section first examines the problems inherent in the bilateral treaty network.

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Holland & Richard J. Vann, *Income Tax Incentives for Investment*, 2 TAX LAW DESIGN AND DRAFTING 986 (V. Thuronyi ed., 1998); Charles E. McLure, Jr., *Tax Holidays and Investment Incentives - A Comparative Analysis*, 53 BULL. INT'L FISCAL DOCUMENTATION 326 (1999); TIMO VIHHERKENTTÄ, TAX INCENTIVES IN DEVELOPING COUNTRIES AND INTERNATIONAL TAXATION (1991); James T. Areddy, *Asian Investment Outlook: A Taxing Issue: Handouts and Holidays - Governments Trade Tax Breaks for New Investment all the Time, But There Isn't Much Evidence it Works*, ASIAN WALL ST. J., May 11, 2000, at S6.

19. See Avi-Yonah, *supra* note 14, at 1579-1603.

20. See OECD, TOWARDS GLOBAL TAX COOPERATION: REPORT TO THE 2000 MINISTERIAL COUNCIL MEETING AND RECOMMENDATIONS BY THE COMMITTEE ON FISCAL AFFAIRS (2000).

*A. Existing Treaty Framework Limits Unilateral Action*

Individual countries often wish to take steps on their own to deal with international tax avoidance. The current treaty network may fail to facilitate, or may even inhibit, such action. This may occur for a couple of reasons.

First, the absence of a multilateral framework means that countries have to take steps on their own. It is often difficult for countries to take unilateral action to curb abuses and expand their taxation of international transactions.<sup>21</sup> A few examples can illustrate this point. A single country may be reluctant to tax interest paid to non-residents because to do so would drive investors away. A single country may be reluctant to tax on a current basis businesses located abroad because that would place its companies at a disadvantage and could cause corporations to flee the jurisdiction, incorporating themselves in countries with more favorable regimes.

In order to feel safe to move ahead, individual countries would need assurance that others also are doing so. To some extent, this assurance can be provided without a formal international agreement. But the existence of a permanent forum with universal membership, created by a multilateral treaty, in the context of which agreements on various issues could be reached, would represent a considerable improvement over the current situation where, at best, agreement to cooperate has to be cobbled together on an ad hoc basis.<sup>22</sup>

Second, existing tax treaties are often inconsistent (or arguably inconsistent) with various anti-abuse measures that countries take or contemplate taking. Thus, not only does the current system not facilitate reforms, it actually may hinder them in some cases. Examples are controlled foreign corporation legislation, rules to tax gains of non-residents on dispositions of interests in real property, and anti-thin-capitalization rules. Each of these provisions arguably is inconsistent with provisions of treaties (in the event of such inconsistency, the

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21. See Avi-Yonah, *supra* note 14, at 1665-68, 1675; WILLIAMS, *supra* note 4, ¶ 216, at 35.

22. The OECD-led effort against harmful tax competition being an example of a relatively informal way in which countries are cooperating under the current regime. Although the OECD Council has taken various decisions pursuant to this effort, they are not legally binding even on OECD members, let alone on non-members.

consequence would be either that treaty obligations are violated, if the domestic law takes the form of a treaty override, or that the treaty can be used to invalidate the domestic law provisions).<sup>23</sup>

A multilateral treaty could facilitate, rather than hinder, reforms which individual countries wish to pursue. To the extent that contemplated reforms are inconsistent with the existing multilateral treaty, countries could discuss and agree on amendments that would permit reform, or even provide for internationally coordinated action. For example, a multilateral arrangement is needed to deal with the taxation of interest income earned by non-resident investors. Whatever arrangement is agreed to—information exchange, a withholding tax, or some combination—all, or nearly all, countries with significant capital markets (end users of capital) must participate, because individual countries cannot go it alone. Formally, a treaty may not be required for concerted action, but if countries can agree on such action, then presumably there would be the basis for entering into a treaty, thereby solidifying the steps to be taken.<sup>24</sup> The multilateral treaty context could institutionalize the process, by providing a forum and procedure for additional agreements, which would be brought from time to time to legislatures for ratification.

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23. See Rigby, *supra* note 5; Daniel Sandler, *Case Notes, Tax Treaties and Controlled Foreign Company Legislation*, 1998 BRIT. TAX REV. 52; Geerten Michielse, *Treaty Aspects of Thin Capitalization*, 51 BULL. INT'L FISCAL DOCUMENTATION 565 (1997); Nicholas Not, *Swiss and French Tax Authorities Disagree on Compatibility of French CFC Rules With Treaty*, 20 TAX NOTES INT'L 2387 (2000).

24. See Avi-Yonah, *supra* note 14, at 1669 (arguing that a uniform withholding tax could be imposed by OECD countries without entering into a tax treaty to do so). Whether a treaty formally is entered into or not seems to be beside the point, however, given that in the absence of a treaty, an understanding would have to be reached among all the countries concerned and uniform legislation conforming to that understanding enacted. This process would not be very different from treaty ratification. A regime for cooperation against tax evasion by nonresident portfolio investors was proposed in HUFBAUER, *supra* note 10, at 68-70. The EU has reached an agreement in principle whereby a directive on taxation of cross-border saving would be adopted by the end of 2002 under which there would be exchange of information, but for a transitional period of 7 years countries could levy a withholding tax. See Henri de Bresson et al., *Les quinze trouvent un compromis dilatoire sur la fiscalité de l'épargne*, LE MONDE (June 22, 2000).

*B. Bilateral Network is Inconsistent with Multinational Business Structure*

The current network of bilateral treaties probably would work well if each multinational corporate group were located in no more than two countries. Each bilateral treaty could then appropriately provide for the taxation of the group. There is, of course, no such constraint on multinational enterprises, which typically establish subsidiaries or branches in a number of countries, including tax havens, in such a way as to take advantage of the existing treaty network. The aim of such tax planning is to go beyond eliminating double taxation and to reduce tax to a minimum. A simple example from the early 1990s can illustrate this point.<sup>25</sup> Suppose that a multinational corporate group headquartered in the Netherlands created a finance company by establishing a branch in Switzerland. A U.S. subsidiary of the Netherlands' company paid interest and royalties to the Swiss branch. Under the U.S.—Netherlands tax treaty, there was a reduced or zero withholding tax on the payments to the Swiss branch. Under Swiss tax law, the branch paid little or no tax, and under Netherlands' tax law the Swiss branch was not subject to tax because it was located abroad. As a result, instead of just eliminating double taxation, the treaty resulted in zero or minimal taxation because the taxpayer adopted a corporate structure to take advantage of the treaty using more than two countries. A protocol was inserted into the U.S.—Netherlands treaty to deal with this case, but the protocol covers only limited situations, and there are still opportunities to use complex corporate structures that are not limited by such anti-abuse rules.

Other structures take advantage of inconsistent treatment of the same legal arrangement under the tax laws of different countries. Taxpayers can exploit such inconsistencies to achieve a favorable after-tax result.<sup>26</sup> For example, a taxpayer in one country may issue a hybrid financial instrument to a taxpayer in another country, structured in such a way that

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25. The example is taken from Yves Bonnard, *The Triangular Case in the New U.S.—Netherlands Tax Treaty: Mechanisms and Tax Planning*, 23 DENV. J. INT'L L. & POL'Y 161 (1994). I am told that changes in the law make this specific transaction no longer feasible.

26. See generally TAX MANAGEMENT INT'L F. (June 2000); Avi-Yonah, *supra* note 3; Rosenbloom, *supra* note 3.

payments are treated as deductible interest in the hands of the payor but as exempt dividends in the hands of the payee. Another case is that of a cross-border finance lease. The lessor's country may grant depreciation allowances to the lessor, while the lessee's country treats the lessee as the owner of the property and allows the lessee to depreciate it. Other structures take advantage of the inconsistent characterization of an entity: One country may consider a given entity to be an independent taxpayer, while another country involved in the transaction may disregard the entity for tax purposes.

Cross-border arbitrage of this sort violates what Avi-Yonah has called the single-tax principle: Income from cross-border transactions should be subject to tax once and only once (it should not be subject to double taxation, but also should not escape taxation).<sup>27</sup> While some steps can be taken to implement the single-tax principle on a unilateral<sup>28</sup> or bilateral basis,<sup>29</sup> a better solution, at least for some of the problems arising from a mismatch between different systems, is a multilateral one under which countries would agree to provide consistent treatment in certain areas<sup>30</sup> or to make adjustments for specified cross-border transactions that would otherwise be treated inconsistently. For example, it is not inconceivable that a harmonized set of rules distinguishing finance leases from operating leases could be agreed upon, under which finance leases would be assimilated to loan transactions. Likewise, the problems stemming from a "check the box" regime could be minimized by a multilateral agreement under which a given

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27. See Avi-Yonah, *supra* note 3.

28. See *id.* See also David I. Kempler, *United States*, 22 TAX MGMT. INT'L J. 41 (2000); Francis G. Sandison, *United Kingdom*, 22 TAX MGMT. INT'L J. 38 (2000); Christian Emmeluth, *Denmark*, 22 TAX MGMT. INT'L J. 13 (2000).

29. Recent German treaties include a provision that deals with certain instances of inconsistent characterization. In particular, where such inconsistent characterization leads to exemption in Germany, this provision denies the exemption, applying a foreign tax credit instead. See Agreement Between the Federal Republic of Germany and the Republic of Lithuania for the Avoidance of Double Taxation with Respect to Taxes on Income and Capital, protocol, para. 7 (signed July 22, 1997). This provision would, for example, take care of the hybrid financial instrument noted in the text, but would probably not take care of the other cases.

30. For an example of an agreement on harmonized tax treatment, see RECOMMENDATION OF THE COUNCIL OF THE OECD ON THE TAX DEDUCTIBILITY OF BRIBES TO FOREIGN PUBLIC OFFICIALS (1996). While not legally binding, it represents a political commitment by the OECD member countries to harmonize their tax rules by denying a deduction for bribes.

type of entity would be treated consistently by all countries party to the agreement. An effective solution to problems of cross-border arbitrage would require a continuing review of the technical interaction between (and among) tax systems. The best candidate for such a task would be an international organization charged with cooperation in taxation (as discussed below).

### *C. Bilateral Network Represents a Fragmented Approach*

By its very nature, the bilateral treaty network is suited to working out problems between individual countries, but not so well suited to providing an architecture that works for the world tax system as a whole. Each treaty is negotiated under a *do ut des* approach.<sup>31</sup> This makes each treaty *sui generis*, with provisions set so as to balance the competing interests of the two countries involved. The implications for the worldwide system are often a subordinate consideration. Most-favored-nation clauses may, however, inject a multilateral dimension, as will the bargaining precedent which any concession can establish, so the story is not purely one of two countries negotiating in isolation.

As a result of this approach, the bilateral treaty network has, to some degree, become imbalanced. Treaty negotiators often consider treaties to be a way of providing benefits for the businesses headquartered in their country,<sup>32</sup> instead of thinking about how the treaty fits in with the global tax system. By contrast, while a multilateral treaty allowing for bilateral derogations will not solve all problems arising from individual reciprocity immediately, it inevitably will get negotiators thinking about the global picture and will provide them with a tool to reach multilateral understandings that prevent treaties from being abused and that provide for an appropriate division of taxing jurisdiction over corporate groups that extend over more than two countries.

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31. See Franz Wassermeyer, *Does the EC Treaty Force the Member States to Conclude a Multilateral Tax Treaty?*, in *MULTILATERAL TAX TREATIES: NEW DEVELOPMENTS IN INTERNATIONAL TAX LAW* 17 (Michael Lang et al. eds., 1998).

32. See 76 TAX NOTES 1 (1997) ("We have the treaty program to serve the needs of our private sector, and we are advocates for our private sector.")

*D. Triangular Cases are Difficult or Impossible to Handle Bilaterally.*

Bilateral treaties can avoid double taxation between two countries, but there are situations involving more than two countries that they cannot handle, or can handle only with difficulty. These include so-called triangular cases; for example, where a taxpayer resident in State A has a permanent establishment or other activity in State B, and pays interest to a taxpayer in State C, which is related to the activity in State B. In such a case, even if there are tax treaties between each of States A, B, and C, the normal treaty provisions will not work because the interest will be sourced in both A and B.<sup>33</sup> While many aspects of triangular cases can be dealt with through bilateral treaties, the more effective approach is a multilateral one.<sup>34</sup> In the above case, it is possible for the treaties to provide that the source of the income is State B, but this may not be appropriate where State B is not a party to tax treaties with the other states. So-called triangular cases are the flip side of the coin discussed above, where a taxpayer exploits a bilateral treaty by setting up branches or subsidiaries in more than two countries. In the (relatively rare) triangular cases, multi-jurisdictional location decisions can lead to double taxation.

The question of how and to what extent triangular problems are in fact dealt with, or could in theory be dealt with, in bilateral treaties is a complex one and beyond the scope of this article.<sup>35</sup> I think it is fair to say that, regardless of whether these problems adequately *could* be dealt with bilaterally, in practice they will not be adequately dealt with bilaterally for the foreseeable future. Most existing treaties have limited, if any, provisions covering triangular cases. Moreover, adequate resolution of triangular cases would require comprehensive treaty coverage and a harmonized approach. A multilateral approach, therefore, seems to be the only feasible way to deal

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33. See John Avery Jones et al., *Tax Treaty Problems Relating to Source*, 1998 BRIT. TAX REV. 222; OECD, 1992 REPORT ON TRIANGULAR CASES (1992).

34. See Nils Mattson, *Multilateral Tax Treaties – A Model for the Future?*, in INTERNATIONAL STUDIES IN TAXATION: LAW AND ECONOMICS 243, 252-55 (Gustaf Lindencrona et al. eds., 1999).

35. See, e.g., Avery Jones, *supra* note 4, at 25-37; Kees van Raad, *The 1992 OECD Model Treaty: Triangular Cases*, 33 EUR. TAX'N 298 (Sept. 1993).

with these problems.

Beyond these perhaps unusual cases, there are a number of important areas that simply cannot be dealt with bilaterally. These include arrangements whereby a tax base is apportioned among a number of countries.<sup>36</sup> Such an arrangement could, for example, be applied to multinationals, either globally or partially.

### *E. Incomplete Coverage of Countries*

While the current network of treaties covers the OECD countries fairly comprehensively,<sup>37</sup> it falls far short of universal coverage throughout the world. Supposing that there are, say, 150 countries interested in being party to a comprehensive treaty network, this would imply 11,175 treaties. Assuming approximately 1,700 treaties now, this implies a coverage of only about 15%. (It is even worse if one included, say, all 183 current IMF member countries, which would require 16,653 bilateral treaties.) Admittedly, some countries are not interested in developing a tax treaty network, but it appears that most countries now have such an interest.<sup>38</sup> Among other reasons, countries find entering into tax treaties attractive as a means of encouraging international investment, obtaining better terms for their own residents engaging in international transactions, and strengthening their administrative ability to tax non-residents or their own residents (through improved information exchange).<sup>39</sup> Entering into treaties also has become important because countries often include in their domestic tax rules rather stringent provisions for taxing non-residents, on the assumption that these will, by and large, be negotiated away by treaty.<sup>40</sup> This leaves countries who are not treaty

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36. See Vann, *supra* note 5.

37. Out of a possible 552 bilateral treaties, the OECD member countries were parties to 475 treaties as of 1995. See Avery Jones, *supra* note 4, at 3.

38. See AMERICAN LAW INSTITUTE, *supra* note 11, at 2 ("There is a remarkably broad and well-established consensus among governments of various political and economic persuasions that it is in their interest to enter into income tax treaties."). Developments since the time that statement was made bear it out, as numerous transition countries in particular have vigorously moved to establish a treaty network.

39. See UNITED NATIONS, *supra* note 10, at 1.

40. See Avery Jones, *supra* note 4, at 3-4. Such stringent provisions may be included as a bargaining chip for treaty negotiations. They also may be used as a



partners in a disadvantaged situation.

Under a bilateral network, universal coverage is almost impossible to achieve, because it takes substantial time to negotiate and ratify each treaty. Moreover, smaller countries typically do not have the resources needed to negotiate numerous treaties, and may have higher priorities. Only under a multilateral treaty could the majority of developing countries hope to enter into an extensive tax treaty network. The current regime, therefore, effectively precludes countries with smaller economies from fully participating in the treaty network.

#### *F. Problems of Interpretation and Amendment*

A multilateral treaty would have the advantage of a uniform text,<sup>41</sup> even if there are substantial derogations. The current network of bilateral treaties involves substantial complexity, because each treaty is a different legal instrument. Therefore, lawyers, administrators, and courts spend a lot of energy interpreting treaties. If the basic provisions of tax treaties were embodied in a single multilateral treaty, interpretation would be easier, because a common understanding would develop about the meaning of the text, which also could be amended relatively easily if ambiguities were noted.

The current treaty network suffers from several major flaws from the point of view of interpretation.<sup>42</sup> As with any statute, treaties need to be interpreted when applied to specific cases. Taxpayers and administrators seeking to apply a particular provision naturally will look to precedent—either administrative or judicial—for guidance. The difficulty with the current situation is that because each treaty is legally on its own, there is no guarantee that even common provisions will be interpreted in the same way by different authorities (courts or tax administrators) in different countries.<sup>43</sup> This leads to con-

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weapon to attack tax havens, which generally are not treaty partners. One problem with such an approach is that the affected countries include not just tax havens, but also countries that are trying to operate a normal tax system, but just have not had the opportunity to become a treaty partner.

41. See Mattson, *supra* note 34, at 255.

42. See generally Kees van Raad, *Interpretation and Application of Tax Treaties by Tax Courts*, 36 EUR. TAX'N 3 (1996).

43. See Loukota, *supra* note 9, at 90. See also PHILIP BAKER, *DOUBLE TAXATION CONVENTIONS AND INTERNATIONAL TAX LAW* 39-41 (1994) (noting that there are relatively few cases where a court refers to decisions of a foreign court in

fusion and legal uncertainty. (The extent of the problem is mitigated by the role of the OECD Commentary, but the commentary does not cover all issues and its status involves legal problems of its own, discussed below.)

Further confusion is caused by the fact that the language of existing treaties sometimes varies slightly from the language of the Model or from other treaties concluded by a particular country.<sup>44</sup> The variation in language may arise from differences in translation or just variation in wording which may not have been carefully thought through by the treaty negotiators (or may have been left as is, in the desire to conclude the negotiations). In such cases, it may not be clear whether the wording differences should lead to a difference in interpretation or not.

Numerous cases arise under current practice requiring either amendment or interpretation of the OECD Model.<sup>45</sup> Indeed, the OECD now has published the Model in a loose-leaf format so that it can be updated periodically. The process of amendment and interpretation is not ideal. Although the commentary has been cited in judicial decisions,<sup>46</sup> its legal effect is unclear. The introduction to the commentary itself discusses the significance to be given to the commentary in interpretation. While the OECD finds that the commentary "can . . . be of great assistance in the application and interpretation of the conventions," that tax officials "give great weight to the guidance contained in the Commentaries," that taxpayers "make extensive use of the Commentaries," and that they "frequently played a key role in the judge's deliberations" when a court was interpreting a treaty, it falls short of saying that the commentaries have a legally binding effect.<sup>47</sup> While as a matter of policy, it clearly makes sense to use the commentaries as an aid in interpreting treaties, the legal basis for such use as a

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interpreting tax treaties).

44. See Wassermeyer, *supra* note 31, at 17, 29-30.

45. See, e.g., the description of items being considered by the OECD's working party on tax treaties in Daniel Luthi, *OECD Work on Tax Treaties*, in THE OECD MODEL CONVENTION: 1997 AND BEYOND (unpublished proceedings of a seminar held in New Delhi in 1997 during the 51st Congress of the International Fiscal Association) (on file with author).

46. See OECD, *supra* note 2, ¶ 29.3, at 15. See also BAKER, *supra* note 43, at 28-29.

47. See OECD, *supra* note 2, at 14-15.

matter of public international law is elusive.<sup>48</sup> An additional issue is whether amendments to the commentary can be applied with retroactive effect; *i.e.* to treaties negotiated before the amendment.<sup>49</sup> For practical reasons, it would be desirable to do so, given the infrequency of treaty renegotiation. Otherwise, amendments might take decades to come into effect. An additional problem is that amendments to the Model can be applied only to newly negotiated or renegotiated treaties. Therefore, instead of making amendments to the Model, the OECD tends to fix problems by creative interpretation, again not an ideal solution because the interpretation often does violence to the language of the Model and therefore may not have a good legal basis.<sup>50</sup> National courts might not agree with it, especially where applied retroactively. To the extent that the interpretation takes place in OECD reports that are not included in the Commentary, it may carry even less legal weight.

These problems can be resolved under a multilateral treaty. Amendments to the treaty could be made with immediate effect. As for interpretation, the international organization administering the treaty could be authorized to issue legally binding interpretations.<sup>51</sup> Where considered desirable (such as

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48. See Hugh J. Ault, *The Role of the OECD Commentaries in the Interpretation of Tax Treaties*, in *ESSAYS ON INTERNATIONAL TAXATION* (Herbert Alpert & Kees van Raad eds., 1993); BAKER, *supra* note 43, at 28-31, advocates a "pragmatic" approach, referring even to subsequent commentaries insofar as they are persuasive. It seems that the legal basis for the use of the Commentary can be strengthened by mentioning the Commentary in a Memorandum of Understanding to each treaty. See Avery Jones, *supra* note 4, at 19-21. However, with respect to existing treaties this has been done only rarely, so it would take a long time for this solution to be effective for most treaties.

49. See Ault, *supra* note 48. See also BAKER, *supra* note 43; Klaus Vogel, *Tax Treaty News*, 54 BULL. INT'L FISCAL DOCUMENTATION 98 (2000) (later Commentaries are not "valid retroactively legally speaking"); OECD, *supra* note 2, ¶¶ 33-36.1, at 16; Avery Jones, *supra* note 4, at 21-25. AMERICAN LAW INSTITUTE, *supra* note 11, at 54, argues that the ALI Commentary should be given "substantial weight" on the ground that treaty negotiators should be familiar with the OECD Model as interpreted by its commentary and should be considered to "accept the common meaning of that language as agreed among the OECD Member countries." This argument of course applies only to the commentary as it existed at the time of negotiation of the treaty.

50. See Vann, *supra* note 5, at 108, 110 (interpretation of Model in respect to thin capitalization).

51. Cf. van Raad, *supra* note 42, at 6-7. See also KEES VAN RAAD, *INTERNATIONAL COORDINATION OF TAX TREATY INTERPRETATION AND APPLICATION* (forthcoming 2001) (proposing creation of a body within the OECD which could give non-

in cases where the interpretation sets forth a new view of the treaty) the interpretation could be given prospective effect; *i.e.* it could apply to transactions occurring after the new interpretation is issued.<sup>52</sup> This is not an option in the case of the current OECD commentary. Either this must be applied on a prospective basis only, in which case it will not apply to *treaties negotiated* before the amendment (as opposed to *transactions occurring* before the amendment), or it must be applied retroactively (*i.e.* to all open tax years). There is no possibility of a middle ground.

### *G. Incomplete Coverage of Taxes*

The bilateral treaty network mostly covers income taxes. While there is an OECD model treaty on estates, inheritances, and gifts,<sup>53</sup> the treaty network in this area is quite sparse and a multilateral effort may be the only feasible means to achieve a broad coverage to eliminate double taxation of capital transfer taxes.<sup>54</sup> Capital transfer taxes also can involve triangular situations (such as where an individual is domiciled in two states and a third state is a situs state). These better can be dealt with through a multilateral treaty. Social security taxes are the subjects of some treaties, but this network too is quite sparse.

Tax coordination with respect to the VAT is done mostly within the EU. There currently is no mechanism for coordination of VAT issues outside the EU. While indirect taxes raise fewer issues of international coordination, they are not insignificant, and are growing in importance with the rise of e-commerce, for example. Interestingly, indirect taxes have, in several cases, been dealt with successfully by multilateral treaties.

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binding advisory opinions at the request of national tax courts). I would argue that the proposal advanced here would be more effective than that of van Raad, because national courts generally are not in the habit of asking others for advisory opinions.

52. The possibility of giving prospective effect only to an interpretation explicitly should be provided for in the multilateral agreement. *Cf.* I.R.C. § 7805(b) (2000) (allowing retroactive effect of regulations in certain cases).

53. OECD, MODEL DOUBLE TAXATION CONVENTION ON ESTATES AND INHERITANCES AND ON GIFTS (1982).

54. See Derek Devgun, *Multilateral Capital Transfer Tax Treaty Relief Within the European Community*, 20 EUR. L. REV. 451, 457 (1995).

The most prominent case is customs duties.<sup>55</sup> Multilateral agreements cover a whole host of issues in customs and substantial harmonization has been achieved with customs legislation.

Given the number of treaties that would be required, it virtually would be impossible to negotiate on a bilateral basis the treaties required to cover all taxes other than the income tax. However, it would be manageable to do this on a multilateral basis.

### *H. Inflexibility*

Paradoxically, as the network of bilateral treaties becomes more successful, it also becomes increasingly inflexible and, therefore, weaker over time.<sup>56</sup> Changes need to be made to treaties for a number of reasons. Changes to national tax laws, which may be made for domestic reasons, often call for conforming changes to treaties. Changes in the international economic environment can make existing treaties obsolete. For example, as the status of countries as capital importers or exporters shifts, so may their treaty stance.<sup>57</sup> Technical flaws in treaties are often detected, sometimes as the result of their application to new circumstances. The OECD periodically recommends changes to its Model tax treaty.<sup>58</sup> However, it is quite difficult to make frequent changes in the current network of treaties, because changes would involve renegotiation of existing treaties, and this occurs on average only at lengthy intervals. The consequence in the case of a change to the OECD Model is that the old and new provisions will exist side-by-side for a number of years. This is confusing and unsatisfactory. Finally, a fundamental policy change is almost impossible to make, given that countries are locked into the paradigm inherent in the existing treaty network. For example, it has been realized for a long time that the existing approach of treaties suffers from an artificiality in distinguishing among

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55. See Williams, *supra* note 4, ¶¶ 444-446, at 89-90.

56. See *id.* ¶¶ 402-403, at 77-78.

57. See, e.g., OECD, *supra* note 2, at 10 (noting shift in status of certain countries).

58. See, e.g., OECD, ISSUES RELATED TO ARTICLE 14 OF THE OECD MODEL TAX CONVENTION (2000); OECD, THE APPLICATION OF THE OECD MODEL TAX CONVENTION TO PARTNERSHIPS (1999).

different types of income, which can be exploited by taxpayers by recharacterizing income, and which leads to problems of application of treaties.<sup>59</sup> It is nearly impossible to deal with this problem under the current framework. In addition, the bilateral approach rules out solutions (such as apportionment) that would require multilateral agreement.

The existing inflexible network of treaties cannot hope to handle the dynamic economic changes that are putting pressure on tax administrations. These changes take the form of increasing globalization—which makes for a decreased connection between taxable transactions and particular countries—and financial innovation—which challenges the existing legal categories on which tax rules (particularly those in treaties) are based. In order to be able to hope to respond to the challenges of globalization and financial innovation, tax policy officials must keep thinking and innovating even without taking international aspects into account. It is difficult enough to amend national tax legislation to respond to these challenges. But, to amend bilateral tax treaties on a timely basis virtually is impossible. This will be an ongoing issue. Tax treaties must be able to respond flexibly to changing decisions of national policymakers. Bilateral treaties simply are inadequate structures to accomplish this task. What is needed is a multilateral treaty with an ongoing process for revision and amendment.

Far from serving as a means of dealing with tax policy challenges, the existing network often impedes innovative solutions. When treaties stand in the way, some countries have resorted to treaty overrides. A more desirable approach would be to agree on the necessary amendments to treaties, something that can be accomplished more readily in a multilateral context.

### *I. Treaty Shopping*

Under a network of bilateral treaties, the terms of which are different, treaty shopping is always a problem. Whenever a country provides more favorable rules for certain treaty partners, an incentive is created for investors to use or establish companies in those treaty partners, rather than making the investment through a company located in a treaty partner with

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59. See, e.g., Avery Jones, *supra* note 4, at 12-17.

a less favorable provision. The bilateral approach invites the treaty shopping problem because the principle of reciprocity in treaty negotiation (*"do ut des"*) leads to differences in treaties arising out of different negotiations. Different treaties involve a package of different concessions. To some extent this problem is being taken care of by the insertion of most-favored-nation clauses into treaties (the automatic extension of favored terms that the treaty partner grants to anyone else). But not all such treaties have such clauses. The problem of treaty shopping would not go away under a multilateral treaty, but it should be much diminished, because a multilateral treaty would be negotiated with a global view.

#### IV. FAVORABLE FACTORS FOR MULTILATERAL AGREEMENT

##### A. *Introduction*

Although I tend to be an idealist, I would not pretend that just because a multilateral treaty makes sense it will be easy to broker the necessary political agreement. Experience with tax policy suggests, however, that just because a reform is considered politically impossible, does not mean it will not happen.<sup>60</sup> Currently, a number of favorable factors help set the scene for a multilateral agreement, making it more likely than in earlier periods.

##### B. *Success of the OECD Model*

Paradoxically, the very success of the OECD Model for a bilateral treaty has made it propitious to replace the bilateral network with a multilateral treaty. The increased number of bilateral treaties makes it time consuming to make amendments, thereby making the bilateral network less flexible as more and more bilateral treaties are concluded.

The end of the Cold War also has contributed to the development of a number of so-called transition countries. For the most part, these countries are eager to enter into tax treaties. However, for many of these countries the necessary personnel

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60. When I was at the Treasury Department in 1984 working on the proposals that led to the Tax Reform Act of 1986, many considered the possibility of fundamental reform to be a pipe dream, but it happened, even though not all desirable elements finally were included.

with the skills to negotiate tax treaties are in short supply, and frankly, these resources would be better devoted to improvement of tax administration. Even industrialized countries have a limited tax treaty negotiating staff, so that building a full network of bilateral treaties that would include the transition countries would take considerable time. By contrast, they could accede much more readily to a multilateral treaty. A multilateral framework appears to be the only realistic way to bring the transition countries into the tax treaty network. Moreover, including these countries in a multinational tax organization would help them strengthen their tax administrations and adopt the best taxation practices.

### C. *The Demands of European Law*

European law protects the freedom of movement of employees, the freedom of establishment of companies, the free movement of services, and the free movement of capital (so-called fundamental freedoms).<sup>61</sup> European law prohibits member countries from discriminating against non-residents in such a manner as to violate these fundamental freedoms. Such prohibition applies to a member's treaty law as well as to domestic law.<sup>62</sup> The bilateral treaty network to which EU member countries are parties may not be compatible with European law. Considering, first, treaties among EU member states, these treaties tend, by their nature, to be discriminatory because the terms of the treaties that a given member state has with other member states are different. Discrimination against residents of other member states also can arise from treaties that a member state has with non-members. For example, Germany's treaty with the United States has an anti-treaty-shopping clause. The result of such a clause is that a German resident could be denied the benefits of the treaty if it is owned by non-residents. This is clearly discriminatory against capital ownership by non-residents.<sup>63</sup> The distortionary effect of dif-

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61. See Albert J. Rädler, *Most-Favored Nation Concept in Tax Treaties*, in MULTILATERAL TAX TREATIES: NEW DEVELOPMENTS IN INTERNATIONAL TAX LAW 3, 10 (Michael Lang et al. eds., 1998). See also Sture Bergström, *Restrictions on Free Movement and the Principle of Non-Discrimination in EC Law and the Implications for Income Taxation*, in INTERNATIONAL STUDIES IN TAXATION: LAW AND ECONOMICS 45 (Gustaf Lindencrona et al. eds., 1999).

62. See BAKER, *supra* note 43, at 60-62.

63. See KLAUS VOGEL, TAXATION OF CROSS-BORDER INCOME, HARMONIZATION,



fering treaties is magnified (somewhat paradoxically) by steps that the EU has taken to increase the freedom of movement within the Community.<sup>64</sup> Thus, the parent-subsidiary directive has eliminated withholding taxes for dividends paid to a parent company. This means that European companies can establish a subsidiary in any other member country without a tax disincentive. The fact that member countries have different treaty terms with the outside world means that European companies will now have an incentive to treaty shop within Europe. The combination of the parent-subsidiary directive and the existence of differences in treaties that EU members have with other countries creates a distortion in favor of establishing subsidiaries in countries with favorable treaties. This kind of tax-induced location distortion is exactly the problem the parent-subsidiary directive was supposed to eliminate. Clearly, harmonization of treaty policy would be desirable as a means of bringing about a common market within Europe.<sup>65</sup>

Because of the complexity of jurisprudence involving discrimination (sometimes discrimination can be justified), and because of the limited number of cases that the European Court of Justice (ECJ) has considered, the precise requirements of European law in this area have yet to be worked out.<sup>66</sup> Recently, however, the ECJ came out with a clear decision that European Law prohibits discrimination in tax treaties. The court stated that

[I]n the case of a double-taxation treaty concluded between a Member State and a non-member country, the national treatment principle requires the Member State which is party to the treaty to grant to permanent establishments of non-resident companies the advantages provided for by that treaty on the same conditions as those which apply to resident companies.<sup>67</sup>

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AND TAX NEUTRALITY UNDER EUROPEAN COMMUNITY LAW 15 (1994).

64. See RAMON J. JEFFERY, *THE IMPACT OF STATE SOVEREIGNTY ON GLOBAL TRADE AND INTERNATIONAL TAXATION* 144 (1999).

65. See COMMISSION OF THE EUROPEAN COMMUNITIES, *REPORT OF THE COMMITTEE OF INDEPENDENT EXPERTS ON COMPANY TAXATION* 31, n.1, 206, 378 (1992).

66. See generally *THE COMPATIBILITY OF ANTI-ABUSE PROVISIONS IN TAX TREATIES WITH EC LAW* (Peter Essers et al. eds., 1998); Rene Offermanns & Carlo Romano, *Treaty Benefits for Permanent Establishments: The Saint-Gobain Case*, 40 *EUR. TAX'N* 180 (2000); *TAX TREATIES AND EC LAW* (Wolfgang Gassner et al. eds., 1997).

67. Case C-307/97, *Compagnie de Saint-Gobain, Zweigniederlassung Deutsch-*

The court gave short shrift to the argument that the discrimination could be justified as part of the bargaining process in negotiating treaties: "that double-taxation treaties are based on the principle of reciprocity and that the balance inherent in such treaties would be disturbed if the benefit of their provisions was extended to companies established in Member States which were not parties to them."<sup>68</sup> The court answered this argument simply by observing that "the Member States nevertheless may not disregard Community rules."<sup>69</sup>

Given that it would be a diversion from the main theme of this article, and in light of the embryonic state of European law in this area, I will not speculate further precisely how the ECJ might apply the principles of European law to treaties. Based on the existing jurisprudence, however, it seems reasonably safe to assume that future ECJ decisions will hold that the existing treaty network violates European Law in several respects.<sup>70</sup> Accordingly, it appears quite possible that the tax treaties of EU members (including those entered into with non-member countries) will have to be replaced with a single multilateral treaty in order to conform to European law.<sup>71</sup> It is even possible that the EU itself has acquired competence to negotiate tax treaties in areas directly concerned with the parent-subsidiary directive or other areas where the EU has acted to implement European law.<sup>72</sup> Whatever the precise

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land v. Finanzamt, 1999 E.C.R. I-6161.

68. *Id.* ¶ 55.

69. *Id.* ¶ 57.

70. See Essers et al, *supra* note 66, at 209-13.

71. See Rädler, *supra* note 61; Wassermeyer, *supra* note 31; COMMISSION OF THE EUROPEAN COMMUNITIES, *supra* note 65, at 378-79. In the *Saint-Gobain* case, the ECJ ruled that a German branch of a French company was entitled to the same benefits under the U.S.-German treaty as German companies. In particular, the treaty provided for exemption by Germany of dividends subject to tax in the United States which were paid to German capital companies. The court found that St. Gobain's German permanent establishment was entitled to this exemption. See *Saint-Gobain*, C-307/97. In effect, therefore, a French company was obtaining the benefits of the German treaty. Little by little, therefore, the ECJ already seems to be eroding the bilateral nature of the current treaty network.

72. See JEFFERY, *supra* note 64, at 145-68. This theory is supported by a statement in the *Saint-Gobain* decision: "in the absence of unifying or harmonising measures adopted in the Community, in particular under the second indent of Article 220 of the EC Treaty (now the second indent of Article 293 EC), the Member States remain competent to determine the criteria for taxation of income and wealth with a view to eliminating double taxation by means, *inter alia*, of international agreements." See *Saint-Gobain*, C-307/97. The parent-subsidiary directive is,

scope of the legal doctrine that emerges in this area, it appears that the current treaty network violates, in a number of respects, the principle of non-discrimination, and that, as a matter of policy, the conclusion by EU members of a single multilateral treaty would be desirable as a matter of furthering the fundamental freedoms. If the EU members determine to do so, this would require renegotiation of the majority of the bilateral treaties currently in force. This would constitute an excellent opportunity to replace the current bilateral network with a multilateral treaty. Put another way, negotiations to form a multilateral treaty would provide the EU member countries with an escape from the problem they currently face: The possible illegality of the current treaty network on the one hand, and considerable political inertia on the other hand.

Of course, as with any major tax reform, there will be political obstacles to accomplishing a revision of the existing EU treaty network. In particular, the renegotiation of bilateral treaties between EU members and non-member countries on a common basis will not be an easy task. In some cases, such treaties are the basis for corporate structures designed to minimize taxation by using tax havens.<sup>73</sup> Such structures present an opportunity for reform, in the sense of reducing the use of tax havens, but such reform can be expected to be resisted by those who benefit from the current system.

#### *D. Willingness for Multilateral Cooperation*

Recently, the OECD countries have undertaken several initiatives that suggest an increased willingness to cooperate in the tax area on a multilateral basis. The OECD published a report on harmful tax practices and has undertaken to combat harmful tax competition. A similar initiative has been taken within the EU. The OECD countries also obtained agreement on a report on bank secrecy which involves a commitment to broaden the exchange of information. An effort is underway to provide for an automatic exchange of information on interest income of non-residents. The EU has reached agreement in

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of course, such a harmonizing measure. Thus, the ECJ suggested that the individual EU member countries have lost competency in this regard, although it did not spell out precisely what this means.

73. For example, the Netherlands Antilles, which has a treaty with the Netherlands. See GINSBERG, *supra* note 14, at 12-15.

principle on a regime for the taxation of interest income of non-residents, involving a combination of information exchange and a withholding tax (to be imposed by certain countries for a limited period), but a multilateral agreement involving non-EU OECD member countries may be needed to bring this agreement into effect.<sup>74</sup> The details of these efforts are not relevant here. What is of interest is that these various initiatives show that the major industrialized countries seem interested in building a multilateral framework for taxation. What is needed is to undertake a more systematic approach.

### *E. Pressure from Globalization*

Increased globalization and the pressure that this places on countries' tax systems has become commonplace. There seems little doubt that the extent of international transactions is increasing and that there is a resulting pressure on tax revenue because international transactions afford an opportunity to reduce tax; whether by legal or illegal means.<sup>75</sup> Thus, the urgency of fashioning a multilateral framework for cooperation has increased compared with what it was 10, 20, or 30 years ago.

## V. PROPOSED STRUCTURE FOR A MULTILATERAL TREATY

### *A. General Structure*

The proposed multilateral treaty would replace the existing network of tax treaties with a single multi-part treaty. (The existing treaties would remain in force during a transition period.) The first part would be a common template for bilateral treaties, initially based on the OECD Model. The second part would be a multilateral treaty, based on the template in part one, but adjusted to take account of its multilateral nature. (This part would not be subscribed to by all countries, at least initially.) The third part, which could evolve over

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74. See Avi-Yonah, *supra* note 14, at 1667-69; Speech of Frits Bolkenstein (Sept. 25, 2000) ("It was also agreed that discussions should take place with the U.S. and certain key countries, such as Switzerland, Liechtenstein, Monaco, Andorra, and San Marino in order to promote the adoption of equivalent measures in these countries and thus preserve the competitiveness of European financial market[s].").

75. See Avi-Yonah, *supra* note 14, at 1597-1603.

time, would contain general undertakings for cooperation in international taxation (for example, non-discrimination, refraining from unfair tax competition, or agreements on information sharing). The fourth part of the treaty would be institutional, providing for an international organization to administer the treaty and for procedures. Finally, derogations and transitional arrangements would provide a bridge between the existing treaty network and part one of the agreement.

### *B. Common Text Based on OECD Model*

The idea of part one of the agreement would be to replace the existing network of bilateral treaties with a single text. This would result in a dramatic simplification of the existing legal verbiage (which takes several volumes in print form) and would provide benefits, as discussed above, in the form of a common text which could be subject to common interpretation and, by agreement, amendment. Given peculiarities in national tax systems and in bilateral relations, it is not expected that all divergences between the common text and bilateral treaties can be eliminated. Therefore, there would be a substantial network of derogations. Over time, it is hoped that the extent of derogations would be limited to those that truly are necessary. For example, minor differences in wording, which do not reflect strongly held national policy views, should give way in favor of the benefits of uniformity.

A proposed text for a multilateral tax treaty recently has been drafted by a group headed by Michael Lang.<sup>76</sup> This group decided to make only minimal changes to the existing OECD treaty, because "it is easier to implement a multilateral tax treaty if the draft is based on familiar notions."<sup>77</sup> Certainly, it makes sense to base the treaty text on the OECD Model if it is desired to fold the existing bilateral treaties into a common text. However, it seems unduly cautious to refrain from making any changes at all. Surely some drafting improvements could be made without departing from "familiar notions." Decades of experience with treaties based on the OECD Model

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76. See Michael Lang et al., *Draft for a Multilateral Tax Treaty*, in MULTILATERAL TAX TREATIES: NEW DEVELOPMENTS IN INTERNATIONAL TAX LAW 197 (Michael Lang et al. ed., 1998).

77. *Id.* at 193.

have generated substantial commentary suggesting technical changes; sometimes arising from differences between the English and French texts of the Model.<sup>78</sup> It should be possible to reach agreement on changes which clearly improve the existing text. Indeed, the prospect of such improvements should be one of the motivating factors in favor of a multilateral agreement. Even if no changes were made to the existing text of the OECD Model, the resulting template would reflect technical amendments agreed upon by the OECD members; which are reflected in existing treaties only to a limited extent because of the slow pace of negotiation and renegotiation. Undoubtedly, there are many other proposed technical changes in the pipeline which could be incorporated into the uniform text. Ideally, a small team with expertise in drafting and experience with the treaties currently in force would be appointed by the negotiators to formulate a text. The text prepared by the group headed by Lang certainly could be taken as a starting point by this team, but hopefully substantial improvements could be made even while sticking to "familiar notions." While it is tempting to offer suggestions, I refrain from doing so here because the draft text will be the result of negotiation and the drafting instructions will have to be determined as a political matter by those involved in the negotiation, in order to accommodate the various interests concerned and to achieve an agreement.

I will make only two general observations. First, it would be desirable from the point of view of simplicity and legal certainty to have the official text in only one language. Alternatively, the number of official languages should be kept to a minimum, as was done for the WTO agreement.<sup>79</sup> In fact, if the text carefully is drafted in each official language (and not just translated), the existence of more than one language actually might facilitate interpretation, since an ambiguity in one version of the text might be cured by consulting another version. Multilingual drafting would require a substantial input of time and skill into the preparation of a multilingual text, however, but this should be manageable because the text is not very long. If such care is not used, then the use of more than

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78. See, e.g., John F. Avery Jones et al., *The Non-Discrimination Article in Tax Treaties*, 1991 BRIT. TAX REV. 359.

79. See JOHN H. JACKSON, *THE WORLD TRADE ORGANIZATION: CONSTITUTION AND JURISPRUDENCE* 143 (1998).

one language easily can lead to contradictions in the text.

Second, it would be desirable to include in the text standard options for certain provisions. The purpose of including standard options is to bring deviations from the standard text as far as possible into a uniform format. A key source for such options would be the UN Model. Not all provisions of the UN Model necessarily need be included as options, but at least those provisions which have gained a reasonable degree of acceptance in actual treaty practice should be included.<sup>80</sup> In addition, other provisions that are found with sufficient frequency in bilateral treaty practice could be included as options.

### C. *Multilateral Version of Common Text*

The common text described above would become a template for existing (when converted) and future *bilateral* treaties. In addition, some countries may be prepared to enter into a multilateral treaty. This would have the same text as the bilateral template, but with some additions and revisions that are peculiar to its multilateral nature.<sup>81</sup> For example, there would be provisions for dealing with triangular cases and there would be provisions for resolution of treaty residence where, absent the treaty, an individual would be treated as a resident of more than one of the contracting states. In addition, as with the existing Nordic treaty, there would be provisions specific to each contracting State, whether in the main text or in protocols.<sup>82</sup> The reason for this dual arrangement (combination of a single multilateral treaty and bilateral treaties) is that not all countries will be willing to join a multilateral treaty. For one thing, some countries may not be ready to be a treaty partner with all the other countries that are party to the multilateral treaty. Given the requirements of European law discussed above, it is to be expected that the core for the multilateral treaty would be the EU member countries.<sup>83</sup> Perhaps initially,

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80. See generally Willem Wijnen & Marco Magenta, *The UN Model in Practice*, 51 BULL. INT'L FISCAL DOCUMENTATION 574 (1997) (survey of the extent of the reflection of 22 specific provisions of the UN Model in 811 treaties concluded between 1980 and 1997).

81. See Mattson, *supra* note 34, at 248-52.

82. See *id.* at 243.

83. For a review of the existing bilateral treaties between EU member countries, see Gerald Toifl, *The Bilateral Tax Treaties Concluded between EU Member States*, in MULTILATERAL TAX TREATIES: NEW DEVELOPMENTS IN INTERNATIONAL

in order to simplify negotiation, it would be ambitious enough for the multilateral treaty to apply to these countries alone. In addition, it may be possible for the EU members to enter into largely *common bilateral treaties* (based on the agreed template, but allowing for deviations in each case depending on the negotiating position) with non-EU countries. Such a set-up, with a common multilateral treaty for the EU and largely common external bilateral treaties, would help preserve these treaties from challenge on the basis of European law.

I do not see the possibility, without inordinate complexity, for a multilateral treaty to work unless each party to the treaty agrees to be a partner with each other country. Otherwise, one may get the following type of problem. Suppose that countries A, B, and C are parties to the treaty, and that countries C, D, and E are parties *inter sese* (i.e. of this group, only C is willing to be a partner with A and B). There might be an individual with residence in A, C, and E with a resulting conflict under the treaties (under one treaty, only A might have the right to tax this individual as a resident and under the other treaty only E might have this right). Similar problems can be envisaged for permanent establishments.

On the other hand, more than one multilateral treaty mutually could coexist with minimal technical problems. Thus, it may be that the European countries could agree on a multilateral treaty and that there would be other multilateral treaties in other regions.

The key to coexistence of these treaties is that all of them—multilateral or bilateral—would be based on the same template and interpreted by the same agency.

#### *D. General Undertakings*

There are many possibilities for countries to reach general agreements to improve the coordination of their tax systems. With respect to jurisdiction to tax, countries could undertake not to expand their jurisdictions too aggressively. Of course, this matter already would be taken care of to some extent by part one of the agreement, but there may be additional areas, for example, not involving the income tax, in which countries could agree to limit their taxing authority so as to avoid double



taxation. Another possible target for agreement is elimination of discrimination in taxation, possibly going beyond the commitments in the existing OECD Model text. On the other side of the coin, countries could undertake to not engage in harmful tax practices; *i.e.* not to provide unduly favorable tax regimes aimed at appropriating for themselves a portion of the tax base that rightly belongs to other countries. While all but two of the OECD countries have made a commitment to avoid harmful tax practices, this commitment is not legally binding.<sup>84</sup> Whether an undertaking to refrain from harmful tax practices could be formulated in such a way as to attract sufficient agreement remains to be seen. But, this is a matter that a multilateral tax agreement should take up and keep on the agenda even if an immediate agreement cannot be reached.

The existing OECD Model only has minimal provisions concerning treaty shopping and treaty abuse generally. On the other hand, a number of bilateral treaties do contain such provisions and there also are anti-abuse provisions in domestic law that may apply to treaties. While it may not be possible at the beginning to reach agreement on rules in this area, strengthened anti-abuse provisions eventually could be included in the multilateral treaty.<sup>85</sup>

A number of problems currently arise because of technical inconsistencies in the tax laws of different countries.<sup>86</sup> For example, there are conflicting definitions of residence for both companies and individuals. There are differences in characterization of companies, so that a single entity may be taxed on a flow-through basis in one jurisdiction and as a separate entity in another jurisdiction. There are differences in characterization of debt and leases. It would be quite useful if countries could agree on common definitions and treatments in these areas and a select few others. This would go a long way toward cutting back on artificial international tax planning transactions and would contribute to the simplification and rationalization of national tax laws. It does not seem beyond the realm of possibility that such an agreement on selective harmonization could be reached. For example, common rules to distinguish a finance lease from an operating lease could be agreed

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84. See OECD, *supra* note 20, at 8.

85. See JEFFERY, *supra* note 64, at 114-17.

86. See *supra* section III.B.

upon, with a finance lease being treated not as a lease but as a loan. For example, substantial harmonization of rules has been achieved in the customs area.

A further possible commitment is one of cooperation in tax administration. This includes, for example, sharing information and developing the administrative capacity to do so more effectively. In a more general sense, cooperation means a commitment to set up procedures and approaches whereby each country sees itself as contributing to an effective worldwide administration of the taxes which each country imposes. To the extent that taxpayers seek to take advantage of international transactions to avoid tax, tax administrations should be working together to assure that these transactions lead to similar tax burdens as those arising from purely domestic transactions. Ideally and eventually, the existing multilateral agreement on mutual administrative assistance in tax matters (currently in force among only seven countries)<sup>87</sup> would become part of the multilateral treaty. If this is not possible, some provisions could be lifted from that agreement, with the fuller agreement being applicable to a more limited number of countries. In this context, it would be desirable to include in the treaty (whether initially or by subsequent agreement) a provision for enforcement of tax debts.<sup>88</sup>

There is scope in the indirect tax area for countries to reach multilateral agreements to eliminate double taxation<sup>89</sup> or to plug holes that exist in the current tax net. For example, international passenger transport (including direct inputs such as airplane fuel) is commonly exempt from VAT or sales taxes. In the case of goods, it is appropriate for exports to be zero rated, because the goods will be taxed on import in the country of destination. In the case of services such as international transport, however, the result is a zero rate of tax. While any one country may be reluctant for competitive reasons to tax international transport, countries could do so if they agree.

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87. Convention on Mutual Administrative Assistance in Tax Matters, *reprinted in* RUFUS RHOADES & MARSHALL LANGER, *INCOME TAXATION OF FOREIGN RELATED TRANSACTIONS* § 85.00 (1995).

88. See JEFFERY, *supra* note 64, at 127-31.

89. See KNECHTLE, *supra* note 6, at 189 (reporting on multilateral convention of 1956 on taxation of motor vehicles, subscribed to by 30 states, under which motor vehicles would be taxed only in the state of registration).

More generally, international services pose a point of difficulty for the VAT, precisely because of the lack of correspondence with goods—if the exporting country zero rates the supply, the importing country will not necessarily tax it. A general regime for cross-border services may need international agreement to be established, because cooperation of both countries involved in a transaction may be required for taxation to be effective.

Cigarette taxation presents another possibility for international agreement. Currently, exports are typically zero rated for excise purposes, while imports are taxed. However, there are serious compliance issues in many countries with collecting cigarette excises on import. If countries could agree to impose a uniform minimum tax on exports (which could be creditable in the country of import), the problem of cigarette smuggling would be reduced and revenues from this source would increase. The revenues could be transferred to the importing country under a clearinghouse arrangement. Another example is duty free shops. Again, the principle of zero rating for exports is applied, but the import typically is not subject to tax because of *de minimis* exemptions. If countries could agree to refrain from allowing favorable regimes for duty free sales (and could regulate sales occurring in international air or water space—the regime of either the country of origin or of destination could apply), the somewhat anomalous and inefficient practice of duty free shopping could be eliminated. Internet sales are of course another topic on which international agreement would be possible. I don't believe that any of these topics necessarily should be included in the initial round of negotiations on a multilateral tax treaty; they are raised here just as illustrations of possible future agenda topics. My point here is simply to illustrate that there would be a substantial agenda of indirect tax issues to take up under the framework of a multilateral agreement.

Tax treaties protect, to a certain extent, against a country's overassertion of tax jurisdiction on a bilateral basis, but they do not do so multilaterally, and do not protect against cases where a country is engaging in harmful tax competition. Trade agreements, by contrast, do protect against harmful competition in the form of export subsidies. It will be a controversial issue whether—and to what extent—a multilateral tax instrument should attempt to impose on countries an international tax order and how the applicable rules are to be coordi-

nated with trade agreements. Perhaps the best way to proceed is for a multilateral treaty initially to contain only minimal restrictions on the tax policy autonomy of countries, for example, non-discrimination provisions and exchange of information agreements, and then leave other possible undertakings, such as prohibition of harmful tax competition, for further discussion and agreement.

A multilateral treaty could, therefore, be seen as the establishment of a process and of a framework for future discussion and agreement, rather than as establishing a full set of rules *ab initio*.

### *E. An International Organization to Administer the Treaty*

#### 1. Membership and Structure

The multilateral treaty should designate an organization charged with enforcing, promoting, and interpreting the treaty, proposing amendments, and, more generally, promoting inter-governmental cooperation in taxation.<sup>90</sup> While the OECD currently plays this role to some extent, it is not ideally suited for it. For one thing, the OECD has limited membership, given its limited membership.

Given the political nature of the question, I do not believe that it is useful for me to discuss extensively what existing or new agency might be entrusted with this task. If a sufficient international consensus develops to negotiate a multilateral tax treaty and entrust its administration to an appropriate agency, whichever agency is chosen will be an outcome of the

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90. See John V. Surr, *Intertax: Intergovernmental Cooperation in Taxation*, 7 HARV. INT'L L.J. 179 (1966) (suggesting the creation of an international organization oriented toward administrative cooperation in tax matters); UNITED NATIONS DEPT OF INT'L ECONOMIC AND SOCIAL AFFAIRS, TAX TREATIES BETWEEN DEVELOPED AND DEVELOPING COUNTRIES, EIGHTH REPORT (1980) (recommending a study for the establishment of a direct tax cooperation council, consisting of high officials of national tax administrations, and supported by a secretariat). An organization for international tax cooperation also has been suggested by Vito Tanzi. See Vito Tanzi, *Is There a Need for a World Tax Organization?*, in THE ECONOMICS OF GLOBALIZATION: POLICY PERSPECTIVES FROM PUBLIC ENEMIES 173 (Assaf Razin & Efraim Sadka eds., 1999) [hereinafter Tanzi 1999]; VITO TANZI, POLICIES, INSTITUTIONS AND THE DARK SIDE OF ECONOMICS 224-27 (2000). Asif Qureshi has suggested the creation of "an international deliberative assembly (with universal membership (contra the OECD)) in tax matters." ASIF H. QURESHI, THE PUBLIC INTERNATIONAL LAW OF TAXATION: TEXT, CASES AND MATERIALS 8-9 (1994).

negotiation process. Certainly, a number of existing agencies could be considered, including the World Trade Organization (WTO) and the World Customs Organization (WCO). The WTO's flexible structure could be adapted to include a Council on taxation, and its subject matter already involves taxation to a significant extent. Placing tax within the umbrella of the WTO would make for a more sophisticated approach to tax within the context of policing restrictions on export subsidies, for example.<sup>91</sup> Another possibility would be to expand the WCO from customs to include all of taxation (customs being a form of tax). If the WCO or WTO were not chosen, they would in any event offer lessons for structuring the new organization, and the new organization would have to cooperate closely with these organizations.

Whatever body is chosen (an existing body or a new body), membership eventually should be nearly universal, but should be conditioned on the satisfaction of specified criteria, as well of course as adherence to the treaty. Not all countries will wish to cooperate by becoming members.

Because each country has a sovereign right to tax, each country should have a representative in this world body. The appropriate representative would be the highest official in charge of tax policy or tax administration—typically the finance minister or the minister in charge of the tax administration in countries where there is a separate ministry. If the WTO is used, provision will have to be made for separate representation, perhaps by creating a separate Council under the WTO umbrella for this purpose.

A one-country one-vote arrangement seems to have worked both for the WTO and the WCO. Such a rule is consistent with each country's sovereignty. In practice, a sufficient consensus has been developed before WTO decisions have been taken. An additional supermajority requirement on the basis of weighted voting could be layered on top of this (e.g., decisions would have to attract a majority of the total votes as well as a majority of the votes of countries with substantial economies).

The tax staff of the organization should, of course, be in-

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91. See generally Justus Fischer-Zernin, *GATT versus Tax Treaties? The Basic Conflicts Between International Taxation Methods and the Rules and Concepts of GATT*, 21 J. WORLD TRADE L. 39 (1987); Paul R. McDaniel, *Trade and Taxation*, 26 BROOK. J. INT'L L. 1621 (2001).

ternational in character. It should be drawn from tax experts of all countries, and it would be desirable for a substantial portion of the staff to be drawn from the ministries of finance and tax administrations of the member countries. While there should be a permanent staff to provide some continuity, it would be important to provide a rotating element for the staff in order to maintain the cooperative character of the organization. Thus, the staff would benefit from an immediate knowledge of practices in the tax administrations of their own countries. At the same time, the highest standards should be applied for selection of the staff.

## 2. Functions<sup>92</sup>

The organization should be a general forum for discussion of the operation of the international tax system, *i.e.* the system for taxing international transactions. Its staff should conduct studies, including statistical studies, on how the system is working, and propose solutions. This should include identification of cases of harmful tax competition and other cases where actions by individual countries were having negative effects on the operation of the international tax system and working toward solutions. In general, the organization should inherit the agenda of the OECD in the tax area. It should continue to do what the OECD Committee on Fiscal Affairs is currently doing, but on an enhanced basis.

As noted above, it would be important to give to the organization a power to interpret the treaty. A power of interpretation already is part of the WTO agreement.<sup>93</sup> This would be an important improvement over the existing situation with the OECD commentary, since the interpretation would be legally binding. The organization would provide a forum for continuous review of experience with the treaty. It would encourage the renegotiation of existing agreements to bring them into line with the treaty, including serving as a forum for multilateral negotiations (a country could renegotiate simultaneously a set of existing treaties with other countries). It would deal with problems of interpretation and application of the treaty and would try to find solutions by way of issuing reports, issuing

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92. See also Tanzi 1999, *supra* note 90, at 173, 184-85.

93. See JACKSON, *supra* note 79, at 44.

formal interpretations of the treaty, and proposing amendments to the treaty text for ratification by the members.

Interpretations would be of general applicability and would not resolve specific disputes. It would be possible to grant jurisdiction over disputes arising in application of the treaty to an international court.<sup>94</sup> However, there is likely to be insufficient political consensus to include such an approach in the initial version of the multilateral agreement. Most likely, countries would prefer for their own courts to consider application of the treaty in specific cases. A provision for arbitration to resolve disputes among one or more countries, in line with provisions included in recent tax treaties, appropriately would be included in the agreement.<sup>95</sup>

While the primary focus of the organization would be to facilitate the operation of the *international* tax system, it also should deal more broadly with taxation, including purely domestic issues. To some extent this would be inevitable, since it is impossible to completely separate the international and domestic aspects of tax systems. On purely domestic taxation, however, the organization should be more of an observer and technical advisor rather than interfering in countries' decisions on tax policy. The organization should gather information on how the tax systems of its member countries operate, including data of a statistical, economic, and legal nature. It should provide technical assistance to its member countries upon request in the areas of tax policy, revenue estimation, and tax administration. In order to provide such assistance in a professional manner, its staff should develop an expertise in international and comparative tax law and analysis. While the staff should not get too large, it should be adequate to deal with its responsibilities. It could take over most of the technical assistance and training functions in the tax area that currently are scattered among a number of agencies.

The organization should become a leader in comparative tax law and policy analysis. It should collect and publish the tax legislation of member countries and lead the effort in improving this legislation at a technical level. As part of its task

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94. See Mario Züger, *Mutual Agreement and Arbitration Procedure in a Multilateral Tax Treaty*, in *MULTILATERAL TAX TREATIES: NEW DEVELOPMENTS IN INTERNATIONAL TAX LAW* 155 (Michael Lang et al. eds., 1998).

95. See *id.* at 159-67.

of interpreting and evaluating the multilateral treaty, it should collect and publish judicial decisions and scholarly writings on tax treaty interpretation.<sup>96</sup> It should assist countries in compiling revenue statistics and publish compilations of the statistics. The organization should publish periodic reports on developments in taxation, "presenting statistics, describing main trends (both statistically and in terms of policy developments), identifying problems, and perhaps pointing toward feasible solutions for those problems."<sup>97</sup>

In addition to providing technical assistance in improving domestic tax administration to member countries with weaker administrative capacities, the organization should become a center for international cooperation in tax administration. It actively should facilitate the cooperation of administrations in areas such as information exchange,<sup>98</sup> joint audits, resolution of transfer pricing cases, and other cooperative efforts to stem tax avoidance and evasion, particularly where international transactions are involved. In so doing, the organization should work closely with regional groupings of tax administrators, providing support to them as appropriate.

The organization could, of course, also become a forum for formal resolution of disputes among countries, as is the WTO for trade disputes. A dispute-resolution role probably should not be included in an original draft of a multilateral treaty, for fear of being too ambitious at the beginning. An alternative would be to provide for limited dispute resolution by agreement.

The budget of the organization could come from dues assessed on members, perhaps based on the relative tax revenues collected in each member country. The total budget should represent only a very small percentage of national budgets devoted to tax administration, reflecting the organization's basic purpose of providing a service to each of its member countries' tax administrations.

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96. See van Raad, *supra* note 42, at 6.

97. Tanzi 1999, *supra* note 90, at 184.

98. See, e.g., Vito Tanzi & Howell H. Zee, *Taxation in a Borderless World: The Role of Information Exchange*, in *INTERNATIONAL STUDIES IN TAXATION: LAW AND ECONOMICS* 321 (Gustaf Lindencrona et al. eds., 1999).



*F. Transitional Arrangements and Derogations*

The process of negotiating a unified tax treaty template presumably would encourage countries to rationalize their bilateral treaty relationships and, therefore, to minimize the amount of derogation. While there would not be complete uniformity, the extent of the differences could be reduced substantially. Replacement of the network of bilateral treaties with a multilateral treaty therefore does not require all countries effectively to scrap all provisions of their bilateral treaties. While it would be desirable to achieve as great a harmonization of bilateral agreements as possible, the multilateral treaty can be designed in such a manner that each signatory can enter reservations.

Existing treaties should remain in effect during a transition period. This would give negotiators time to review existing treaties and determine to what extent the texts can be brought into conformity with the uniform text. Countries would commit to negotiate any new treaties on the basis of the uniform text. This does not mean that there cannot be differences, but that the treaties must take the form of agreement to the uniform text subject to specified deviations. Eventually all tax treaties would be brought into this format.

## VI. CONCLUSION

This paper argues that multilateral action is needed to establish an international organization for cooperation in taxation and a multilateral treaty to replace the current bilateral tax treaty network. While I am confident that the arguments in support of these steps are robust, I am also sure that the road will not be an easy one, given that people tend to be wedded to old ways. One possible bright spot is that there may be more than one road. It would not be necessary for all the elements described in this article to be implemented precisely as envisaged here. For example, an international agency for cooperation in taxation could be established separately, even without an international treaty.<sup>99</sup> This could grow into a formal international organization and could provide a forum for nego-

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99. Tax administrations could enter into agreements to cooperate and could establish a secretariat just by incorporating it under some country's local law, in advance of the creation of a public international organization.

tiation of a multilateral treaty. In addition, or alternatively, steps could be taken in the direction of some of the proposals of this paper by the OECD or some forum created by it. Thus, for example, the OECD recently has created a forum for discussion of harmful tax practices.

